

Office of Chief Counsel
Internal Revenue Service

memorandum

CC:NER:MAN:TL-N-6841-99

AJK:m

date:

to: Chief, Examination Division, Manhattan District
Attn: Maria C. Glasser, Group 1528

from: District Counsel, Manhattan

subject: Estate of [REDACTED]

DISCLOSURE STATEMENT

This advice constitutes return information subject to I.R.C. § 6103. This advice contains confidential information subject to attorney-client and deliberative process privileges and if prepared in contemplation of litigation, subject to the attorney work product privilege. Accordingly, the Examination or Appeals recipient of this document may provide it only to those persons whose official tax administration duties with respect to this case require such disclosure. In no event may this document be provided to Examination, Appeals, or other persons beyond those specifically indicated in this statement. This advice may not be disclosed to taxpayers or their representatives.

This advice is not binding on Examination or Appeals and is not a final case determination. Such advice is advisory and does not resolve Service position on an issue or provide the basis for closing a case. The determination of the Service in the case is to be made through the exercise of the independent judgment of the office with jurisdiction over the case.¹

Edward B. Madden, an attorney with Office of Assistant Chief Counsel (CC:DOM:FS:P&SI), has agreed that use of 10-day post-review is proper with respect to this advice. Thus, no actions based on this advice should be taken until we have informed you that the National Office has confirmed the accuracy of the advice.

¹This advice is rendered on the basis that all representations and facts in this memorandum are correct. We recommend that you verify this information. If any of the representations and/or facts are incorrect or cannot be substantiated, our advice may need to be modified.

Issue

Whether the trust denoted as the "Spouse's Part" of decedent's estate qualifies as a marital, "qualified terminable interest property" ("QTIP") deduction pursuant to I.R.C. § 2056(b)(7)?

Facts

I. General Background

Decedent, [REDACTED], died testate on [REDACTED]. The decedent was survived by his spouse, [REDACTED], his son, [REDACTED], and two daughters, [REDACTED] and [REDACTED]. The assets in the decedent's estate totalled \$[REDACTED]. The decedent's estate claimed a marital deduction, in the amount of \$[REDACTED], under I.R.C. § 2056(b)(7) on decedent's federal estate tax return that was filed on [REDACTED]. Decedent's will was admitted to probate on [REDACTED]. The Service proposes to disallow the entire marital deduction.

II. The Will

Decedent executed his will on [REDACTED]. See Exhibit A, attached. In his will, decedent made certain, specific bequests. See ¶ SECOND, subparagraphs A. through C. Decedent divided the remainder of his estate (the "Residuary Estate") consisting of stocks in closely held corporations and interests in real estate partnerships into two parts: (1) the "Non-marital Part" and (2) the "Spouse's Part".

In paragraph FOURTH, decedent devised the Spouse's Part to his trustees "to pay or apply the entire net income thereof to or for the use and benefit of my wife, [REDACTED], during her lifetime, in monthly or such more frequent installments as my Trustees, in their sole and absolute discretion, may determine." In paragraph TWELFTH, subparagraph B., decedent designated [REDACTED] and [REDACTED] to be trustees of the Spouse's Part trust and as co-executors of his will.

Paragraph [REDACTED] of the will provided as follows:

[REDACTED]

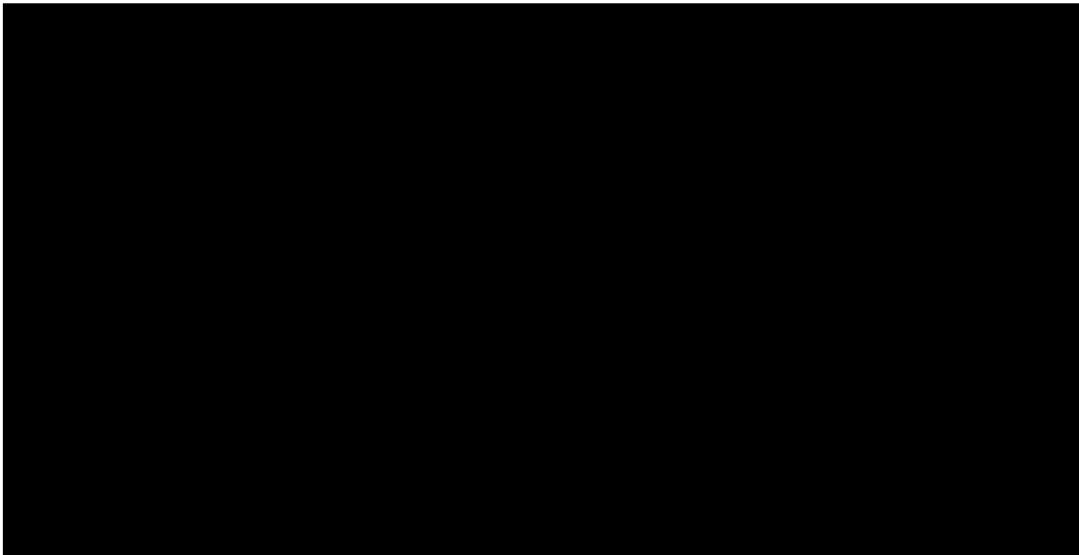


(emphasis added).

III. State Court Litigation Involving Decedent's Will

On [REDACTED], [REDACTED] filed a legal action with the Surrogate's Court, [REDACTED] against [REDACTED] and [REDACTED] (together, as "Respondents"), in their capacity as executors and trustees under the will of [REDACTED]. The dispute involved issues of control and rights as to property of the decedent's estate.

In their pre-trial memorandum, at page [REDACTED], Respondents stated as follows:



[REDACTED]

[REDACTED] (emphasis in original).

As part of the Surrogate Court proceeding, [REDACTED] submitted an affidavit dated [REDACTED]. In her sworn affidavit, she stated in part:

[REDACTED]

[REDACTED]

(emphasis added).

On [REDACTED], the Surrogate's Court, [REDACTED]
[REDACTED], issued an order [REDACTED]
[REDACTED]

[REDACTED]

(emphasis added).

[REDACTED] appealed the Surrogate Court's decision
to the [REDACTED]. In respondents' brief to the Appellate Division,
they stated, in part:

[REDACTED]

By order dated [REDACTED], the Appellate Division
unanimously affirmed the decision of the Surrogate Court.

IV. [REDACTED]
(b)(7)c, (b)(7)d

(b)(7)c, (b)(7)d

[REDACTED]

(b)(7)c, (b)(7)d

(b)(7)c, (b)(7)d

Legal Discussion

Section 2056(a) of the Code provides that for purposes of the tax imposed by section 2001, the value of the taxable estate shall, except as limited by section 2056(b), be determined by deducting from the value of the gross estate an amount equal to the value of any interest in property which passes or has passed from the decedent to his surviving spouse, but only to the extent that such interest is included in determining the value of the gross estate.

Under section 2056(b)(1), a marital deduction is not allowed for certain terminable interests in property. Section 2056(b)(1) provides, in part, that where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail, no deduction shall be allowed under this section with respect to such interest -- (A) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse); and (B) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse.

Under certain circumstances, a marital deduction may nevertheless be allowable with respect to a terminable interest passing to a surviving spouse. See I.R.C. §§ 2056(b)(7) and 2056(b)(5). Section 2056(b)(7) provides that, in the case of QTIP, such property shall be treated as passing to the surviving spouse for purposes of § 2056(a) and for purposes of § 2056(b)(1)(A), no part of the property shall be treated as passing to any person other than the surviving spouse.

Section 2056(b)(7)(B)(i) defines "qualified terminable interest property" as property: (1) which passes from the decedent, (2) in which the surviving spouse has a qualifying income interest for life, and (3) to which an election under

section 2056(b)(7)(B)(v) applies.

Section 2056(b)(7)(B)(ii) provides, in part, that a surviving spouse has a qualifying income interest for life if -- (I) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has an interest for life in the property, and (II) no person has a power to appoint any part of the property to any person other than the surviving spouse.

In this case, the Spouse's Part fails to qualify for QTIP treatment since the surviving spouse is not entitled to all the income from the property. I.R.C. § 2056(b)(7)(B)(ii). The Surrogate Court determined that [REDACTED] possessed legal rights to income from the "Spouse's Part" pursuant to decedent's will.² New York law controls the extent of the taxpayer's legal rights to the property in question but it does not control as to the characterization of the property for federal income tax purposes. United States v. Mitchell, 403 U. S. 190, 197 (1971).

[REDACTED]

The estate may argue that the presence of a savings clause in paragraph [REDACTED] of decedent's will should operate to void any transfer of net income to [REDACTED] and therefore, maintain the QTIP deduction. In paragraph [REDACTED] of his will, the decedent provided, in part, that: "My Executors and Trustees shall exercise their discretion in such manner as shall be consistent with the allowance of an estate tax marital

[REDACTED]

deduction." Savings clauses such as this can only be used as an aid in determining the testator's intent where the instrument presents an ambiguity. See Rev. Rul. 75-440. In this case, the state Surrogate Court determined that [REDACTED] was "entitled" to income from the "Spouse's Part". Accordingly, no ambiguity exists with respect to the savings clause of the will to void the transfer of funds to [REDACTED] which effectively disqualifies the "Spouse's Part" for marital deduction purposes.

If you have any questions regarding this advice, please contact attorney Michelle Or at (212) 264-5473 ext. 239.

LINDA R. DETTERY
District Counsel

By: _____
THEODORE R. LEIGHTON
Assistant District Counsel

Noted:

LINDA R. DETTERY
District Counsel

cc: Michael P. Corrado
Assistant Regional Counsel (Tax Litigation), NER

Edward B. Madden
Office of Assistant Chief Counsel (CC:DOM:FS:P&SI,4040)